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## United States Senate

COMMITTEE ON SMALL BUSINESS

WASHINGTON, DC 20510-6350

April 27, 1999

BY FACSIMILE (202/622-5756)  
ORIGINAL BY U.S. MAIL

The Honorable Charles O. Rossotti  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Dear Commissioner Rossotti:

As a result of the Committee's hearing on April 12, 1999, concerning small business tax filing and reporting burdens, I received some troubling information from the American Hotel & Motel Association (AHMA) pertaining to the Internal Revenue Service's (IRS) Tip Rate Determination and Education Program (TRDEP). I would appreciate your looking into this matter.

Enclosed are two letters that the IRS' Ohio office recently sent to an AHMA member. Both letters have the same date, and both arrived in the same envelope. The first letter (no reference number) notifies the taxpayer that the IRS is conducting a "compliance check" on the business, which will require a review and reconciliation of multiple tax forms relating to the business' designated tax year. This letter goes to great lengths to state that the "compliance check" is not an "examination or inspection," but it could lead to a formal examination in the future.

The letter continues by inviting the taxpayer to consider the Tip Reporting Alternative Commitment (TRAC) and concludes by setting a date for the "compliance check" to begin just days after the date of the letter. The second letter (Letter 3071) describes the alternatives under TRDEP, including the Tip Rate Determination Agreement (TRDA) and TRAC, and again invites the taxpayer's participation in the program.

As we discussed at the hearing, there are a number of IRS forms, letters and notices sorely in need of common-sense review. The first letter described above is a prime candidate in my book. From the taxpayer's perspective there is no substantive difference between a "compliance review" or an "examination" or an "inspection." The review and reconciliation of a minimum of eight returns plus two more for *each* employee is simply an "audit" in the common parlance of the business community. And to complicate the situation further by saying that the "compliance check" could lead to an examination at a future date, merely adds insult to injury.

Notwithstanding the confusing language, I am especially concerned that these letters could be viewed as strong-arming a taxpayer into using the TRAC program and may be in conflict with

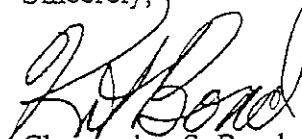
section 3414 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) (the Act). That section directs the IRS to instruct its employees that "they may not threaten to audit any taxpayer in an attempt to coerce the taxpayer into a Tip Reporting Alternative Commitment Agreement."

The second letter alerts the taxpayer that "You can, of course, elect not to participate in [the TRAC program] and continue to comply with tip reporting requirements as you have in the past." Despite this seemingly soothing offer, a reasonable business owner is likely to conclude that he had better sign a TRAC agreement in order to prevent the current "compliance check" from continuing as an audit or examination. I trust that these letters were not designed to achieve that result and ask that you suspend their use immediately until they can be revised. In addition, I would appreciate knowing the number of taxpayers who received this combination of letters since the Act became effective last year.

I recognize that the IRS has a responsibility of ensuring that taxpayers are complying with the law, and I am not questioning the appropriateness of the IRS' decision to review a particular taxpayer's compliance with the law. What I am questioning is the lack of clarity in these letters, which I assume are among the 356 form letters you referenced at the hearing, and the potential appearance of impropriety with respect to section 3414 of the Act.

Thank you for your assistance in addressing this matter. If you have any questions, please contact me or Mark Warren, the Committee's Tax Counsel, at (202) 224-5175. I would appreciate learning of the steps you will take to deal with this situation by May 11, 1999.

Sincerely,



Christopher S. Bond  
Chairman

Enclosures

cc: W. Val Oveson  
National Taxpayer Advocate

Department of the Treasury, District Director  
2 So. Main Street, Akron, OH 44308-1869  
Telephone Number: 1-330/375-5667

Mailing Address :  
INTERNAL REVENUE SERVICE

Date:

Contact:

Employee Identification :

Contact Telephone Numbers:

Pager: 1-800/ 789-8888 ~  
enter pin

The Internal Revenue Service is conducting a compliance program relative to tip reporting regulations under the authority of *IRC 7601*. This program requires a review and reconciliation of the following documents for the \_\_\_\_ tax year.

1. Form 8027: *Employer's Annual Information Return of Tip Income and Allocated Tips*
2. Form 941: *Employer's Quarterly Federal Tax Returns*
3. Form 940: *Employer's Annual Federal Unemployment (FUTA) Tax Return*
4. Form W-2: *Wage and Tax Statement, with Form W-3, Transmittal*
5. Form W-4: *Employee's Withholding Allowance Certificate* - for individuals electing more than 9 allowances and exempt status
6. Related company's income tax return ( Form 1120, 1120S, 1040/Schedule C )

This compliance check does not qualify as an examination or inspection under Internal Revenue Code Sections 7602 or 7605(b), or as an audit for purposes of section 530 of the Revenue Act of 1978. If as a result of this compliance check we decide to open an examination, we will issue a letter notifying you of this action.

I would also like to discuss the Tip Rate Alternative Commitment (TRAC) program with you. The purpose of this program is to ensure maximum compliance by the employees of food and beverage establishments with the statutory provisions relating to tip income. Attached is our invitational letter regarding this program, which I would appreciate your taking time to read. I will be able to answer any questions you have about the program during our compliance check.

I have scheduled an appointment for \_\_\_\_\_ at your place of business at \_\_\_\_\_ for the review.

Please confirm as soon as possible if there is any conflict with the appointment date, time or the meeting place by contacting the undersigned at the above telephone number.

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Also enclosed are Publication 1 (*Your Rights as a Taxpayer*), Notice 609 (*Privacy Act and Paperwork Reduction Act Notice*), and TRAC Program Information. Please take time to read these pamphlets and we can discuss any questions you may have at our meeting. Thank you.

Sincerely,

Tip Program Agent

**Enclosures:**

Pub.1 - Notice 609  
Purpose of Tip Program  
Letter 3071

Department of the Treasury, District Director  
2 So. Main Street, Akron, OH 44308-1869  
Telephone Number: 1-330/ 375-5667

Mailing Address:  
INTERNAL REVENUE SERVICE  
Attn:

Date:

Contact:

Employee ID Number:

Contact Telephone Numbers:

Pager: 1-(800) 759-8888

enter pin

The Internal Revenue Service developed the **Tip Rate Determination and Education Program (TRD/EP)** to assist employers and employees in complying with statutory provisions relating to tip income. Although originally developed for the food service industry, we are now extending the program to other industries where tipping is customary. We invite your voluntary participation in the program.

There are two arrangements available to you in the program. You can choose to participate in either one. These arrangements are: -- the **Tip Rate Determination Agreement (TRDA)**, or,  
-- the **Tip Reporting Alternative Commitment (TRAC)**.

**TRDA**....Under this arrangement, you determine tip rates for the various occupations within your establishment using historical tip data. At least 75% of your tipped employees must sign a Tipped Employee Participation Agreement (TEPA) agreeing to participate. You can choose this arrangement if your business activity is in the food and beverage or the gaming (casino) industry.

**TRAC**....Under this arrangement, the IRS does not require you to establish a tip rate. You do however, agree to institute and maintain a quarterly education training program for newly hired employees and to periodically remind them as to their tip reporting obligations. You also agree to establish procedures to track all tips for reporting purposes. The TRAC arrangement does not require an agreement between you and your employees but it does affect *all* (100%) employees. This arrangement is available to you if your business activity is in the food and beverage or the hairstyling industry.

We are enclosing for your information a sample copy of the arrangement that applies to your business activity. If you are interested in participating in this program, please complete the enclosed Application Letter indicating your choice. Return it to the office shown on the Application Letter within 15 days from the date of this letter using the enclosed envelope. We will contact you to arrange your participation.

As background, Congress enacted Internal Revenue Code (IRC) section 3121(q) in 1988, requiring businesses to pay FICA tax on employees' tip income. In addition, IRC section 6053(a) requires employees who receive tips that exceed \$20 or more in a calendar month to report them to their employer by the 10th day of the month following their receipt.

You can, of course, elect not to participate in this arrangement and continue to comply with tip reporting requirements as you have in the past. We believe, however, that these arrangements provide you a cost-effective method for complying with the reporting requirements.

for: District Director

Letter 3071 (DO) (02-98)